

The Shadow Economy

Richard Cebula and Edgar Feige, economists at the University of Wisconsin-Madison, did a study released in 2011 to measure tax evasion. **In that study they estimated “underground activity” totaled as much as \$2 trillion.** Thus the phrase “\$2 trillion underground economy” was picked up by the media all over the place.

The study also found the “shadow economy” amounts to nearly 8% of the US GDP, and that 18-19% of total reportable income is not properly reported to the IRS.

Cebula/Feige’s study was based economic calculations:

- more money in circulation (more than \$2,900 per capita by the end of 2010)
- a calculated ratio of reported to unreported income
- a tendency toward tax evasion – indicating participation in the underground economy – when the unemployment rate increased and when there was dissatisfaction with the government

HOWEVER, the rest of the speculative and factual comment on the underground economy, accumulated by the media in response to the study, contributed this information:

Aside from illegal activity, such as drug trafficking, the underground economy is comprised of off-the-book work, with the heaviest concentration in the domestic market (nannies and housekeepers), perhaps followed by construction workers (which includes both hourly and day laborers). **These two segments – domestic labor and construction labor – have always been part of the underground economy.**

The next largest sector of off-the-book jobs are in service industries, e.g., food and landscaping, where a greater percentage of the workforce ended up because of the huge job losses of this latest recession. Then there is music and entertainment, information technology and web design.

According to Laura Gonzalez, a personal finance professor at Fordham, most workers in the shadow economy are undocumented. However, Money Morning (in a April 2013 article) says “the biggest contributor to the underground economy in the past few years has been employers increasing their use of freelancers or ‘independent contractors’ – even many who actually work full-time.”

Two key reasons why the underground economy grew so quickly from 2009 to 2012 (*doubled*, according to a study by Friedrich Schneider, a professor at Johannes Kepler University in Linz, Austria):

- economic uncertainty prevented employers from hiring
- employers reduced worker hours to less than 30 in anticipation of Affordable Care Act implementation

Most economists interviewed in the various media stories agreed the underground economy was channeling money back into the mainstream economy, thereby keeping it healthier than it might otherwise have been.

But, of course, they all warned of the dangers of the shadow economy:

--depressed tax revenues

--exploited workers

--no health or pension insurance, no Social Security